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EXTERNALIZING ANAR NON-CORE ACTIVITIES AND ASSETS

28 February 2006

This publication was produced for review by the United States Agency for International Development. It was prepared by Chemonics International, Inc and the Black Sea University Foundation.

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Contract No. PCE-I-00-98-00015-00, TO # 822

LIST OF ABBREVIATIONS

ANAR – National Administration “Apele Romane”- Romanian water management authority
DADL – Danube and [Black Sea] Coast River Basin Directorate – ANAR branch in Constanta
EU – European Union
GD - [Romanian] Government Decision
GO – [Romanian] Government Ordinance
GoR – Government of Romania
Los – Level of service
MEWM – [Romanian] Ministry of Environment and Water Management
OG – Official Gazette (Monitorul Oficial)
QA/QC – Quality Assurance/Quality Control
RBD – River Basin Directorate, river basin branch of ANAR
SCADA – Supervisory Control and Data Acquisition
SEPIC – Support to Enhance Privatization, Investment and Competitivity in the Water Sector of the Romanian Economy – USAID funded project
ToR – Terms of Reference
UGO – Urgent [Romanian] Government Ordinance

TABLE OF CONTENTS

EXTERNALIZING ANAR NON-CORE ACTIVITIES AND ASSETS

I. INTRODUCTION

ANAR is the Romanian institution mandated by the Romanian Government to implement provisions of international treaties in the waters domain to which Romania is a signatory party. ANAR's role is continuously adjusted to cope with the challenges imposed by EU accession and the fulfillment of Romania's international commitments. In support of ANAR's efforts, the SEPIC project developed and submitted two reports dealing with: a) an overview of the problems ANAR is expected to face in the process of accession (*ANAR: Charting a Path to Sustainability*), submitted in April 2004; and b) establishing pricing policies (*Toward Setting Water- and Wastewater-Related Contributions and Penalties in Romania*), submitted in January 2005.

The present report has been prepared as a decision support tool to help ANAR address externalization of non-core activities and assets , as means to optimize use of its financial resources and allow it to concentrate on its core activities. This report was prepared on the basis of a work plan submitted to ANAR and approved by letter dated April 7, 2005.

ANAR aims to achieve the following objectives through externalization:

- Externalize loss-making, non-core activities
- Turn loss-making activities into sources of revenue by externalizing equipment and/or staff
- Reduce or avoid need for investment in non-core activities
- Ensure development and upgrading of depleting non-core activities and assets
- Reduce the burden on management represented by non-core activities
- Reduce fixed costs generated by employing on a full-time basis people who actually work only part-time, such as parts of the maintenance workforce
- Reduce current salary costs (by reducing the number of employees), making room for salary increase of some staff in the fixed-value salary budget item
- Reduce the amount of operations work and workforce and thereby make room for hiring needed management and policy workforce
- Ensure the same or better (a) regular service to customers and (b) emergency preparedness and response capabilities as compared to before externalization
- Reduce costs of ancillary activities, such as procurement, cost of stocks etc.
- contribute to financial self-sustainability

In carrying out this study and analysis we reviewed the relevant Romanian legal framework and externalization tools and approaches applied by international organizations such as the World Bank. We also reviewed externalization experiences and approaches of River Basin Directorates (RBDs). We developed a case study to illustrate the decision-making process. Decisions on where, when and to what extent to externalize activities and assets remain exclusively in the hands of ANAR.

The objective of this study is to illustrate the complexity and the duration of the process as well as to allow a general idea on the entailed externalization costs. It is impossible to cover in one study all the aspects and issues of externalization. We have raised several of the questions that need to be clarified through the documents that need to be developed previous to externalization, without claiming that we have exhausted all the implications of a complete externalization process.

II. EXTERNALIZATION RESULTS

ANAR went through a first externalization round, finalized in 2004, as a result of which the number of employees was halved, as compared to 1990.

In this chapter we focus on externalization performed in the wake of UGO 107/2002, approved by Law 404/2003, setting up ANAR in the form that was kept until January 1, 2006. We processed and interpreted data received from River Basin Directorates (RBDs), in a survey conducted with ANAR support that utilized a questionnaire developed by SEPIC[1].

The total value of externalized assets in the nine RBDS that took part in the survey was 18.533.676 RON (approx. $6.18 million)[2].

A. Perceived reasons for externalization

The main **perceived** reasons for externalization mentioned by RBDs in the survey were:

- externalized activities were non-core activities
- transfer of local interest works to relevant local governments
- externalized activities were loss-making activities
- externalization is required by Art. 2(4) and Art 7 al UGO 107/2002

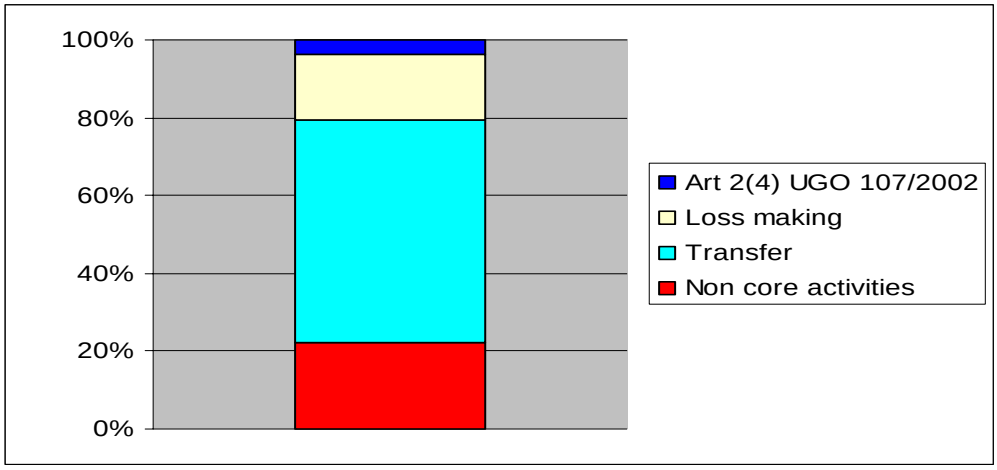

Figure 1. - Perceived justification for externalizing assets

As shown in Figure 1, the main perceived justification for externalization is NOT the administrative decision enforced through GUO 107/2002. This shows that RBDs considered externalization a vehicle to improve efficiency, rather than a matter of implementing an administrative decision imposed on them.

B. Main types of externalized assets

As shown in Figure 2, the main externalized assets were:

- water treatment plants and water pipes
- local interest hydro-technical works (water storage, dikes, bridges)
- other assets (real estate, equipment: machine tools, earth moving, vehicles)

[1] Due to the catastrophic floods of 2005 two RBDs out of 11 did not respond to the questionnaire
[2] Exchange rate: 1 $ = 3.0 RON

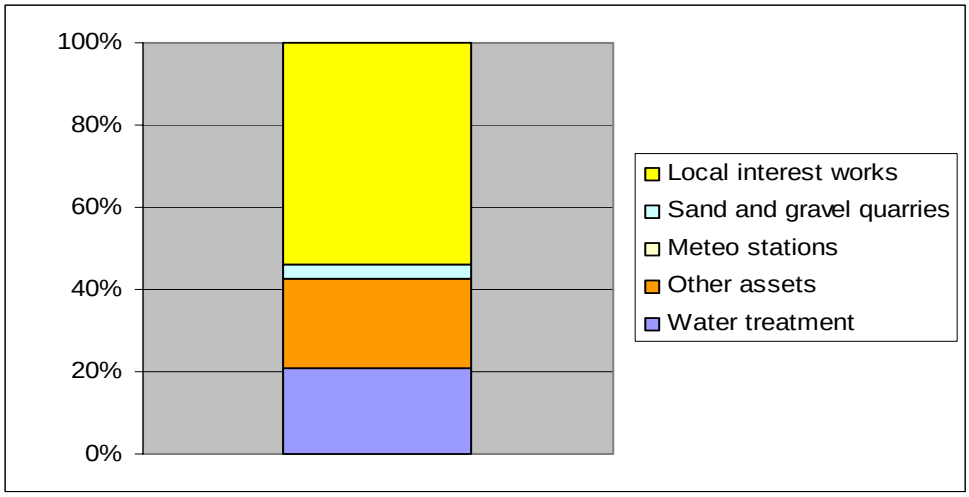

Figure 2. - Value percentage of externalized assets types

The largest proportion in terms of the total value was in local interest works. This component would have been even larger had ANAR not encountered resistance from the local governments that did not want to take over assets. Local governments are reluctant to take ownership of assets due to lack of funds and technical capability to maintain, repair and upgrade hydro-technical works.

C. Main results

The main results of externalization activity by the nine RBDs that were able to participate in the survey were:

- approximately $1.16 million in total annual savings for the nine RBDs
- total number of staff reduced by 85 (approx. 2%) in the nine RBDs

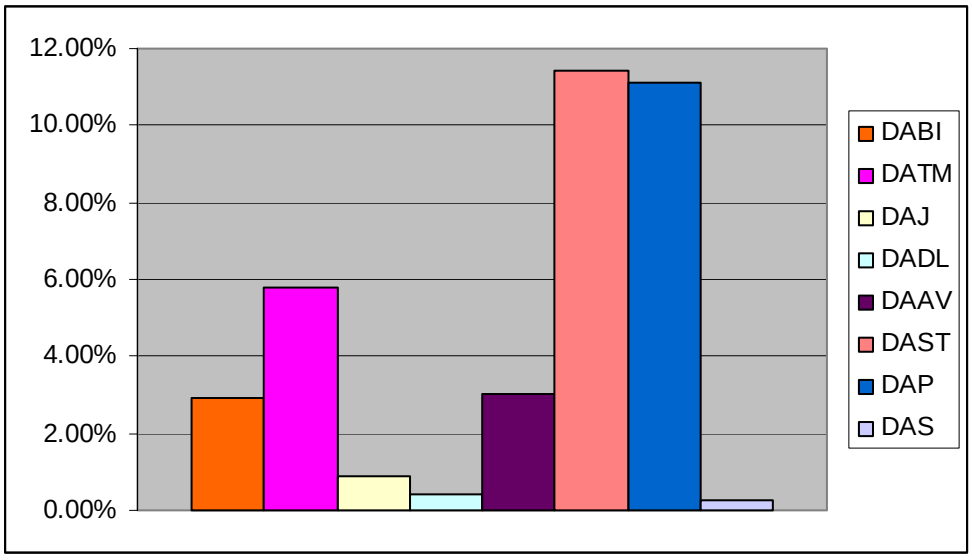

Figure 3. - Resultant savings following externalization, as compared to operational costs

Different RBDs had different experiences and achievements with regard to externalization. Savings vary from insignificant to more than 10%. The greatest savings resulted from externalizing water treatment and distribution infrastructure.

D. Dynamics of outsourcing

Figure 4 shows that the value of outsourced work increased steeply in 2002, most probably as an effect of the GUO 107/2002, by which ANAR was compelled to externalize non-core activities. The increase in 2003 is roughly the same as the inflation rate at that time, so the value of contracts stayed the same, or even decreased. In 2004, the value of outsourced contracts decreased, possibly following pressure from trade unions to increase the workload of existing personnel.

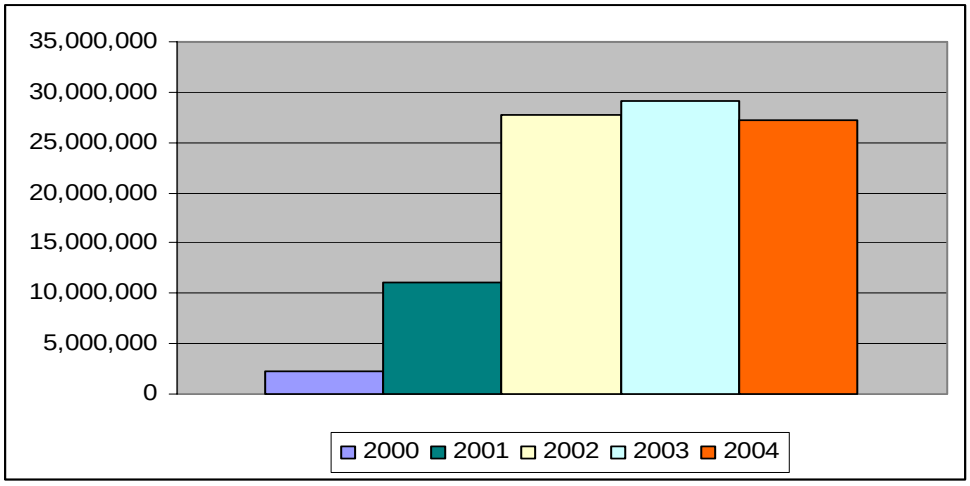

Figure 4. - Total value of outsourced contracts

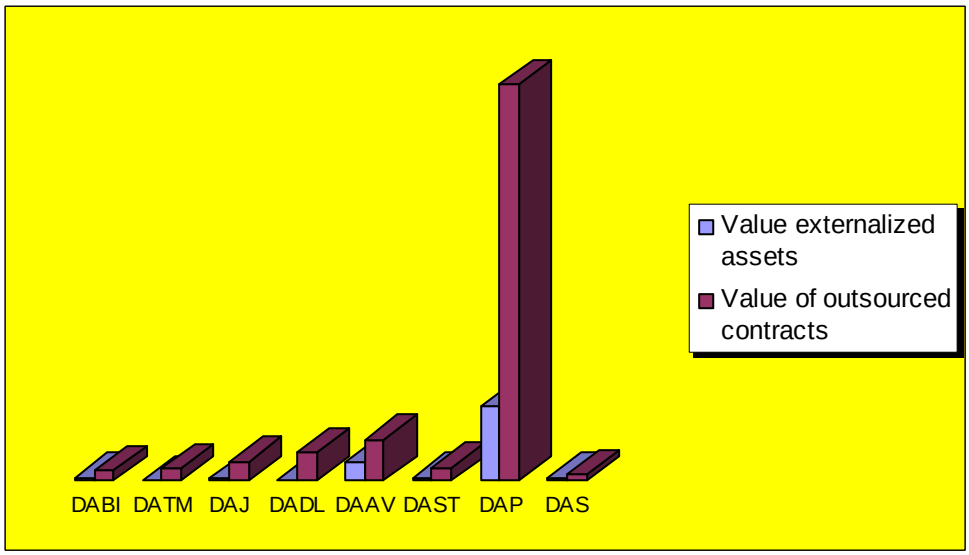

Figure 5. - Dynamics of the value of outsourced contracts as compared to the dynamics of value of externalized assets

Figure 5 illustrates the total values of externalized assets and the total value of outsourced contracts in the period 2000-2004, for eight RBDs. It is interesting to note that there is a quantitative relationship between the value of externalized assets and of outsourced contracts, which may warrant the conclusion that there is a direct relationship between externalization and increased material costs through outsourcing, due to the relevant behavior of top management. We did not have the data needed to show the impact of externalization on cost with salaries.

E. Plans for future externalization

RBDs mentioned the following types of assets they intend to externalize in the future[3]:

- hydro-technical works of local importance, some of which already mentioned in legal documents defining the patrimony of the state, both in the inventories of ANAR and of local councils
- water catchments, treatment and transportation works, including pumping stations
- production and maintenance shops and associated real estate (mainly buildings)
- beach maintenance (DADL)
- equipment operation, repair and maintenance, and vehicles

Effects:

- reduced costs with salaries
- reduced materials and energy costs
- reduced depreciation costs
- reduced load on top management

Difficulties:

- the legal framework allows local councils to deny transfer of title
- potential buyer/owner not known
- social problems associated with consequent unemployment
- no interested bidders
- very long and complex
- process to dispose of state property

Main conclusions deriving from information generated by the survey and from work on previous reports:

- ***Externalization should be driven by the need to increase efficiency and not enforced as an administrative measure. In the absence of studies and business plans developed by specialized consultants to test and prove efficiency increase, top management and employees will resist externalization.***
- ***The externalization process needs to be custom-designed for each RBD, taking into account local conditions such as the status of development of the river basin area, skills of personnel, and more.***
- ***Externalizing hydro-technical works of local importance relieves ANAR of the financial burden to maintain and upgrade them. However, it creates the new burden to inspect them, usually on an annual basis. In the absence of necessary funding, externalized works will continue to degrade and will not be able to fulfill their functions in the event of floods. ANAR may find it necessary to provide technical assistance to communes in contracting and commissioning studies, design work and construction works.***
- ***Different kinds of assets were externalized in the river basins. Acquired experience is a valuable asset, on which ANAR should capitalize, by encouraging RBDs to share experiences amongst themselves.***
- ***Externalizing assets relieves ANAR of the burden to invest in non-core activities, and makes available financial, human and management resources for core activities.***
- ***Publicly owned assets are almost impossible to dispose of due to the lenghty and complex process involved.***

[3] Asset groupings were developed by SEPIC, based on information generated by the survey

III. CONSIDERATIONS REGARDING THE EXTERNALIZATION APPROACH

The main assets ANAR intends to externalize are in the public property category. Art. 2(5) of Law 400/2005[4] requires transfer of publicly owned, local interest works to administrative entities served by these assets. Implementing these provisions will take time and may be difficult, but the law provides a clear solution to the problem.

In the period from 1990 to the present, ANAR has halved the number of staff as a result of externalizing various activities and assets. Unlike other important sectors of the Romanian economy, where the externalization process was developed based on dedicated GoR strategies and according to specific laws, externalization at ANAR was managed by the Board of Directors; this had advantages and disadvantages. ANAR may have come to a point where it would be dangerous to continue externalization unless it is based on serious studies aimed at helping ANAR top management in selecting what and how to externalize, for each non-core activity or asset.

It appears from information provided in the survey that, with the exception of one RBD, most earthmoving equipment in the RBDs is outdated. ANAR will need to make a strategic decision on whether to invest in upgrading this kind of equipment, or instead to partially or totally externalize water course maintenance. In 2005 ANAR successfully managed catastrophic floods. Lessons learned during the floods will impact the way disaster prevention, preparedness and response activities will be managed and conducted.

As of January 1, 2006, ANAR is set up as a public institution.

Implementation of the DESWAT[5] project began in 2005 and in 2006 will begin implementation of WATMAN. Both projects will continue ANAR efforts to apply and use modern monitoring and communication means, including modeling, in water resource management and to prevent and manage crises generated by floods, drought, ice and accidental pollution. Implementing DESWAT and WATMAN will require a sustained staff recruiting and training effort and implementation of a QA/QC system, combined with providing sustainable logistics support in terms of equipment maintenance and calibration, procurement of reagents and optimal stock management, materials and spare parts.

In light of the above considerations and the amplitude of changes they will entail, we detail in the following the main steps and aspects of an externalization process. Description of these aspects is aimed at helping ANAR in its efforts to prioritize and manage externalization activities in accordance with responsibilities dictated by UGO 73/2005, approved by Law 400/2005.

A. Initial conditions

[4] Law 400/2005 approves GO 73/2005, which modifies GUO 107/2002, setting up ANAR

[5] DESWAT (*Destructive Water Abatement and Control of Water Disasters*) . The project deals with: a) river monitoring - water level, rainfall, water and air temperatures, main water quality parameters; b) short and medium term forecasting, using high-performance forecast models and Romanian forecast models in the water decision-making system.

Externalization represents significant change that carries with it risk of technical and commercial problems that could be socially and economically costly. In order to minimize these risks certain conditions need to be met in the larger context in which externalization is undertaken.

To begin, MEWM would adopt a decision to reform the sector, namely: (i) define the post-externalization structure of the sector; (ii) provide guarantees and allocate financial liabilities; (iii) develop an externalization strategy. The strategy would be developed following studies dealing with least cost development, water sector restructuring options, environmental impact, water resources management, and the like.

Next, the necessary legislation should be enacted including assignment of the entity having the role of Regulator of the water domain. The Regulator may be ANAR, or another entity, newly created or existing. The Regulator might, for example, issue norms such as supply code of rules; commercial rules; code of conduit; safety rules including flood protection, emergency plans, draught protection etc. The Regulator also might define eligible customers, licensing rules, contracts, etc. as appropriate.

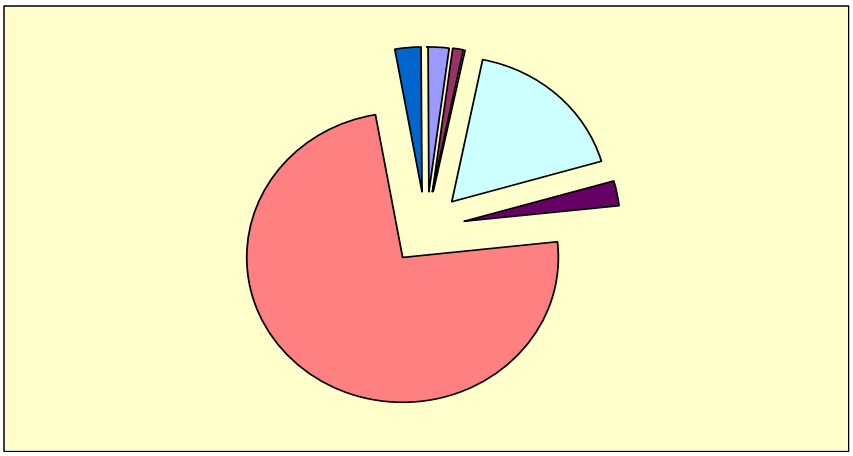

Figure 6. - Comparison of the value of externalized assets in six RBDs

As a following step, based on the water sector externalization strategy of MEWM, ANAR Board of Directors decides on potential for privatizing externalized assets and activities.

Figure 6 shows, for comparison purposes, the value of externalized assets in six of the RBDs that participated in our survey. The RBDs were not named and the values not mentioned, as we considered them irrelevant to our purpose of showing the big differences existing between the different RBDs. Based on information generated by the survey and our previous work with ANAR, it seems that the main causes for these differences are the following:

- top management awareness regarding the necessity and usefulness of externalization
- local social and economic conditions, such as interest and financial power of potential beneficiaries for offered assets, local labor market and unemployment consequent to externalization
- top management's relationship with the trade union
- number and value of assets left for externalization after the first round of externalization

Top and middle management commitment determines their active participation in the externalization process and is paramount for implementing this process. Prior to initiating

externalization top and middle management need to be trained on the need for and the dynamics of externalization.

An important initial condition for externalization is to define the size and scope of the entities to be externalized , such as contracting and revenue collection management, maintenance and repair of hydraulic works, sand and gravel exploitation etc. It is also important that the relevant GoR institution defines the potential for and level of private involvement in the new organizations.

The above external and internal conditions are setting the pace of the externalization process. Development of the necessary studies to develop the externalization strategy, to establish the ownership of the newly created entities etc. should be managed by a Reform Committee set up by either ANAR, or MEWM and by the Water Sector Regulating Agency, which could be ANAR.

In what follows we present the different impact risks which may occur subsequent to externalization. The new companies are not part of ANAR so the monopoly is not there any longer to absorb and mitigate risks. Thus the impacts in cost of risks is better separated from the one of inefficient operation. The roles of: reliability, as a measure to reduce technological risk; of better contracts, against the commercial risks; and of financial instruments, to mitigate financial risks due to various volatilities, are acquiring new importance after externalization.

B. Issues to consider in the externalization process

We have summarized, in Table 1, some of the issues that need to be considered in the externalization process. The table is divided in sections illustrating specific *aspects* of an organization's activity: operations, finances, commercial, human resources and legal. In the left column, we mentioned *issues* that may impact the respective *aspects*. In the right column, we illustrated *recommended actions*, to deal with the mentioned issues. The table is based on similar experiences in externalizing assets and activities in the energy and municipal water services sectors, adapted to the specific case of ANAR.

Table 1 - Issues to consider in externalization

Issue	Recommended approach
Operations	
Privatization (in case privatization is included in the externalization strategy)	• quick privatization: low sale value combined with compulsory level of investment for buyer; financial facilities granted to lure investors • late/no privatization: state takes cheap loans to upgrade. Upon privatization, debt service is passed on to buyer
Maintenance	• specialized services should be kept in-house to avoid creating a monopoly, leading to increased specific costs • general maintenance: adopt adequate contracting and commissioning policies, to provide free access of suppliers and ensure timely and quality supply • predictive maintenance should be implemented, associated with centralized procurement and storage of large parts. Develop reliability data base to help implement predictive maintenance • improve communication and cooperation between the new companies in terms of exchanging information and spare parts to keep costs as low as possible

Procurement	• harmonize procurement practices with international ones, to ensure access to loans on the world market • encourage competition amongst suppliers. New companies will act on a market larger than the former RBD of which they were part • spares for old externalized equipment should be transferred to new company, with the relevant equipment • guarantee for new equipment should be transferred with the equipment to the new company
Quality Assurance	• implement QA/QC system, such as ISO 9000 • certify suppliers. Conduct audits and inspections • train and certify personnel
Finances	
Assets related	• quick privatization: assets re-evaluated to increase value of the deal • late privatization: too early and/or too high re-evaluation leads to increased depreciation costs • careful analysis of balance sheets and simulation of financial operations regimes, before externalization, to ensure that revenues will cover costs • include value of eventual patents or other similar assets • re-allocate arrears and develop arrears recovery plan, if needed
Liabilities	• assessment and allocation of liabilities impact finances and creditworthiness; increase cost of loans • solution: separate credit payment into dedicated company, to free new companies of the burden to pay back loans • include risk component in tariff of new companies • implement risk management unit in new companies, if practical • involve lending institutions in the externalization process • consider covenants stipulated in the loan agreements when designing externalization process • consider environmental liabilities
Investments	• consider impact of investment projects and associated loans • new investment brings more efficient assets, but also debt service repay • involve lending institutions in the externalization process • consider covenants stipulated in the loan agreements • for on going loan negotiations, build creditworthiness of new company, to avoid high lending costs • develop IT and communication capabilities and train staff to use new hardware and software
Guarantees	• guarantees have impact on externalization costs • smaller companies are viewed as higher risk than huge ANAR • smaller revenues usually mean higher costs of short to long term loans, which result in higher externalization costs and may impair sustainability of new companies • new companies should be audited and, if possible, rated • involvement of the state should be very well thought in advance
Commercial	
IT networks	• improve the information flow between ANAR and new companies, and new companies among themselves, if needed • allow fast cost calculation and taking financial and operational decisions • provide planners in water sector the basic information related to supply capacity, availability of resource, consumption needs, economic parameters etc • create environment to implement SCADA and water management systems

Cost calculation	• reduce time for cost calculation • essential for cost control, important in competitive market • price transparency reduces space for arbitrary behavior and enhances competition • thoroughly evaluate assets and liabilities in order to establish tariffs based on reliable data
Contracting	• reduce impact of passing from inter-department relations to contract regulated relations • if possible, establish cost and profit centers inside ANAR to test contracts before externalization occurs • contracts to be "'as simple as reasonably acceptable for the given purpose" • involve regulating agency in developing contracts
Human Resources	
Training	• implement management systems (quality, environment, health and safety) • train management to act and operate on open market • train staff on new regulatory environment • keep ANAR central training facilities and allow access to them, to reduce costs and maintain viability of training centers
Separation plan	• separation: firing, compensation packages, transfer of staff • quick privatization: include social protection measures in the privatization contract. Time sensitive to allow new owner to implement own HR policies • late privatization: smooth separation, include social protection • letting people go to soon will leave the new companies without experienced personnel, which no training can replace on short term
Filling positions in the new companies' diagrams	• administrative structure of the new companies must be devised before externalization • staff may not be sufficient or available for some positions, particularly finance and economics • scout for skilled personnel outside ANAR, if needed • time sensitive. Staff needed at the time new company begins operation to ensure viability
Communications	• develop communication plan ahead of externalization • external and internal communications devised in harmony • external communications: creditors; public; media, politicians • internal communications to present externalization process to the management, the unions and the personnel at large • separate communication plans, customized to targeted audience • timely release of information carefully considered and done • communication plans better when based on specialized studies • various groups of interest and the media may take advantage of a badly done communication and even create social unrest
Union involvement	• merits: accelerate externalization process and bring more opinions to the table • union leaders lose benefits from down scaling size of company • externalization leads to union unbundling • unions should be a stake holder in the human resource plan and not in the whole unbundling of the company.
Legal	
Regulatory framework	• new companies stakeholders in developing legal framework • rules for licensing and contracting • establish algorithms for benchmarking • develop code of conduit and technical code to avoid arbitrary or monopolistic behavior

Conclusions:

- ***When developing the externalization strategy it is important to review:***

  a. ***The assets and liabilities of the resulting companies, according to legal provisions. If privatization was previously selected as an option, special analysis may be needed. Analysis should be conducted by specialized companies. In the case of privatization, bidders will undertake their own due diligence analysis***

  b. ***Personnel training needs and proper allocation of trained personnel to the new companies, to ensure their ability to operate technically, commercially, financially and legally***

  c. ***The financial situation of the new companies, in terms of: i) existing loans and associated obligations resulting from the clauses of the loan agreements, such as: juridical personality, ownership, state guarantee status; and ii) aspects related to risk perception of the involved financial entities, such as: political risk, financial and foreign exchange risk, country rating, etc.***

  d. ***The physical limits of separation and balanced allocation of responsibility***

  e. ***The potential environmental impact and the emergency preparedness and response capabilities of the new companies, as compared to the relevant Romanian legislation. Externalization may alleviate costs by transferring responsibilities to the externalized companies but, at the same time, generate costs to develop and apply verification and monitoring procedures that ensure their readiness to perform their emergency preparedness and response duties, at least in the same conditions as prior to externalization. Decision on externalization should be pending on the balance of these costs.***

- ***In the case of similar state monopolies, such as energy generation and distribution, oil extraction and processing and irrigation, the process was conducted based on a privatization strategy. The strategy was developed over several years, with support from specialized consultants, who submitted different options to the GoR. Finally, the respective strategies were approved by the GoR and the Romanian Parliament (ex. Law 570/2004 for privatizing "Electrica" company). The strategies were implemented gradually, to soften their impact on the economy and public at large. Water management will remain a state monopoly. However, in light of the importance of the water sector, ANAR's numerous responsibilities and the potential negative impacts of an externalization that is not fully thought through, planned and prepared, ANAR's externalization should be preceded by conducting thorough studies to ensure implementation of the externalization plan with minimal costs and in a manner that avoids negative impacts***

Environment	• consider environmental compliance schedules • consider implications of historical pollution • compare to relevant EU laws • important in privatization negotiations, but also for viability of new company

IV. LEGAL FRAMEWORK FOR EXTERNALIZATION

A. Romanian legal framework

Article 136 of the 2003 Constitution of Romania defines property owned by government entities as "public", or "private." ANAR manages public property assets, mostly included in the "public property" of the state. A generic inventory of these types of assets, as defined by relevant Romanian legislation, is included in the text box below. A part of ANAR's assets are privately owned by ANAR. "Public property" assets may be offered for concession or leased (Law 219/1997), may be objects of public-private partnerships and may be managed by others through management contracts. Assets in the "private property" of the state may be the object of the same transactions as those in the "public property" and may also be sold, or privatized.

I. Constitution of Romania of 2003, Art. 136, on property (official translation)
(1) Property is public or private.
(2) Public property is guaranteed and protected by the law, and belongs to the State or to territorial-administrative units.
(3) The... waters with their energy potential that may be used for national interests, the beaches, the territorial sea, the natural resources of the economic zone and the continental shelf, as well as other possessions established by the organic law, shall be public property exclusively.
(4) Public property is inalienable. Under the terms of the organic law, public property may be managed by autonomous régies or public institutions, or may be leased or concession granted on it; also, it may be transferred for free usage to public utility institutions.
(5) Private property is inviolable, in accordance with the organic law."

II. Assets included in "public property" of the state, as defined in Appendix to Law 213/1998 (official translation)
3. surface waters with their minor beds, shores and basins of lakes, underground waters, interior maritime waters, cliff and beach of the sea, with their natural wealth and their energy potential that can be turned to account, the territorial sea and bottom of maritime waters, interior navigable waterways;
5. ....pieces of ground obtained by damming, draining, and soil erosion control works;....
9. the natural resources of the economic zone and of the continental shelf, together with the continental shelf;
13. navigable channels, basins of canals, hydro technical constructions relating to canals, locks, protection and consolidation of shores and slopes, safety zones on shores of canals, access roads [to] and territories on which these are made;
16. main channels and distribution networks for irrigations with the corresponding taps;
18. reservoirs and their dams, in case the electric power producing activity is connected to the national energetic system or to those with blocks for the attenuation of high flood waves;
19. defense dams against floods;
20. water course regularization works;
21. hydro technical cabins, hydrological, meteorological, and water quality stations;
22. military and civil, river and maritime ports - the grounds on which these are situated, dams, quays, stone packing and other hydro technical constructions for the mooring of boats and for other activities of civil navigation, basins, access channels and aquatoria, technological roads in ports, historic monuments existing in ports, quays and stone packing situated on the shores of navigable waterways outside of port precincts destined for navigation activities;
29. grounds and the buildings in which they unfold their activity..... other specialist bodies of the central public administration and the public institutions subordinated to them; the decentralized public services of the ministries and of the other specialist bodies of the central public administration as well as the prefectures, except those acquired from own extra budgetary revenues, which shall constitute their private property."

III. Law 219/1997, regarding concession of publicly owned assets
Art. 2. - (1) Public property goods shall be inalienable. Under the terms of the law they may be placed under the administration of self-managed public companies or public institutions, or they may be conceded or leased.

(2) Public services, activities, or goods from the following domains may form the object of a concession: ..

g) economic activities linked to artificial and natural waterways, water management works related to them, water quality, meteorological and hydrological measurement installations and stations, fish protection works;

h) public property real estate, beaches, wharfs, and free zones;

k) drinking water public distribution and transport networks;

n) natural resources of the maritime economic zone and of the continental shelf;

o) sports grounds, recreation grounds, and professional show institutions;

t) any other public services, activities or goods which are not prohibited by special organic laws.

Law 219/1998 regulates concession and leasing. In 1999 the Romanian Government adopted guidelines for implementing Law 219, spelling out the procedure for granting a concession, from requesting bids to signing and implementing the concession contract, including the format of related documents. Figure 7 below lays out the legal framework for externalizing public property assets..

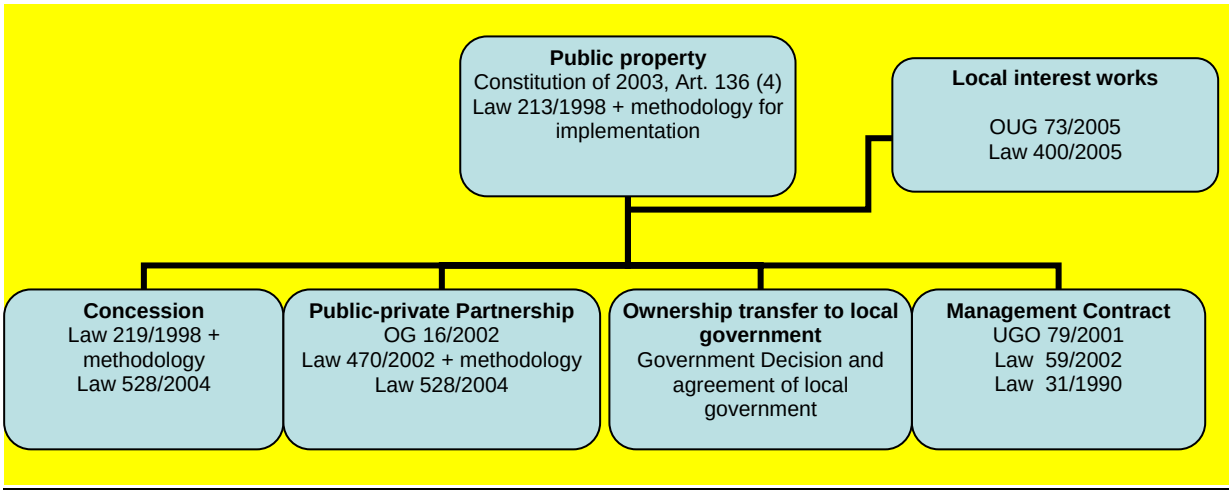

Figure 7. – Legal framework for externalizing publicly owned assets

B. EU legal framework

In 2004, the EU Commission prepared a communication titled "A pro-active Competition Policy for a Competitive Europe" which describes the importance of competitiveness for fostering economic growth. In 2005-2006, a large number of existing State aid rules are due for renewal, including all the State aid exemption regulations, the regional aid guidelines, the framework for research and development aid and the risk capital guidelines. The environmental aid guidelines expire at the end of 2007. These considerations and the beginning of a new programming period for the Community's structural funds in 2007 will require a comprehensive review of the State aid rules (in accordance with the cohesion policy set out in the forthcoming Structural Funds regulations), as well as consolidating and simplifying the rules.

V. EXTERNALIZATION VEHICLES

A. Introduction

Externalization of the assets may be done to the public or the private sector. Externalization to the public sector is done by transferring the assets to another government entity, through a Government Decision. In what follows, we shall only describe options to involve the private sector in the externalization of both public property and private property activities and assets.

There are several alternatives to secure private sector participation in water-related services. Options depend on: a) the type of property of the assets to be externalized, ("public" or "private"), and b) the policy of transferring risk to and the subsequent sharing of revenues with the private sector. Externalization of "public" property assets could be done by delegating the management and development of such assets to a privately-controlled company and retaining ownership of the assets, through concession, leasing (affermage), management or other types of contracts. Table 2 illustrates possible externalization approaches, depending on the title of the assets.

Table 2. - Options for externalization

Instrument	Assets in "public property"		Assets in "private property"	
	Externalized to:			
	Public organizations	Private organizations	Public organizations	Private organizations
Service contract		x		x
Management contract		x		x
Lease		x		x
Buy/operate/transfer		x		x
Joint venture		x		x
Concession		x		x
Sale			x	x
Title transfer	x		x	

B. Sustainability considerations

The first step in externalization is to set up the activity and/or the assets to be externalized as a separate entity. In setting up this entity, we recommend taking into consideration at least the following issues:

- *Size of the new entity*: The new entity should be sustainable in terms of financial, human, and physical resources compared to the services ANAR expects it to deliver. A business plan should be developed to test and ensure the viability of the new entity. The new entity should not be burdened by transfer of financial losses, should have adequate personnel in terms of number and skills and the materials and equipment to perform the job for which it is created. Ideally the new entity should have a portfolio of contracts to keep it running for the first months. Size is particularly important when ANAR seeks to sell, or privatize, the new entity. Serious investors may not be interested in very small businesses.

- *Prices vs. costs*: Keeping in mind water contribution constraints, the cost of services provided by the new entity is very important. If the prices the new entity can charge will not cover costs, or will not allow sufficient profit margins, private investment is unlikely, and public not-for-profit providers may be trapped in a credit squeeze: they may neither have their own resources to finance investment nor be creditworthy to apply

to banks for loans (unless, of course, they are subsidized by the state or are backed by sovereign guarantees). It may also happen that the cost of services provided by the externalized body is higher than the cost of the same services provided by a department of ANAR. This would make externalization unattractive to ANAR, at least in the short term.

- *Management and marketing capabilities*: If ANAR is looking to enter into a partnership or to sell the new entity, management and marketing skills may be contributed by the partner. If ANAR wishes to keep control of the new entity and the objective is to turn a loss-maker into a profit-maker, it is important that the new management be able to run the company as a profit center and market the services of the new entity.

- *ANAR's externalization efforts:* ANAR needs to seriously consider the effort needed to prepare activities and assets for externalization and, depending on the selected externalization approach, consider needed resources and the cost of monitoring externalization contractual arrangements. Furthermore, the 2005 floods have demonstrated the need for reliable, well trained and adequately equipped service providers in case of emergencies. These costs, as well as associated management implications, should be accounted for by ANAR in deciding whether or not to externalize and what the externalization method will be, and in preparing and negotiating contracts.

C. Possible effects of private participation

Experience has shown that privatization in the water sector has not always and automatically led to improved services. A private investor has a strong incentive to be profitable. To this end, the private investor will tend to provide services with fewer staff, ensure proper quality of the work to avoid costly repairs, base investment decisions strictly on economic efficiency considerations and, depending on quality of enforcement, will improve environmental compliance.

Efficiency of private participation will depend largely on the arrangements of the investor or private operator with ANAR. In the following paragraphs we describe usual arrangements and corresponding allocation of risk and revenues, in order to ease decision making. The following basic principles should be taken into account in developing a fair deal:

- consult stakeholders in the design of the arrangement
- anticipate and design fair allocation of risk resulting from changing circumstances, such as currency devaluation, fluctuation of prices for energy and occurrence of extraordinary events
- fair and appropriate arrangements for monitoring performance
- fair and transparent selection of private partner or investor

D. Summary of externalization options

1. Service contract

The simplest form of involving the private sector is to contract out specific operations and maintenance activities, usually for a period of one to two years. Service contracts can cover a wide range of activities. Typically, they cover maintenance, emergency repairs and interventions, billing and collection, upgrading of existing or construction of new facilities, equipment rental, computer systems maintenance, or laboratory testing. The private contractor

is responsible for achieving performance indicators included in the contract, complying with the applicable laws and regulations and is liable for services performed under the contract. The private contractor manages its own personnel and services.

The service contractor normally does not finance investments in water management infrastructure. The contractor is typically paid in stages on a unit price or lump sum basis upon completion of work. With a service contract, the public institution bears all the commercial risk and retains overall responsibility for policy setting, operating, maintaining and financing the system.

2. Management contract

The management contract represents a more comprehensive arrangement than a service contract. The public institution transfers responsibility for the management of the entire operation and maintenance of a system (activity or asset) to a private company, usually for a period of three to five years. In some cases the contractor is paid based on performance indicators.

The private operator assumes full responsibility for day-to-day management, but does not take on any commercial risk. It has no direct legal relationship with the consumer and acts at all times on behalf of the public authority. The public institution retains policy development and financial responsibilities for the system and for providing the funds necessary for working and investment capital.

A private operator may be paid: 1) a fixed fee for services; or 2) based on achieving performance targets. One challenge is to include targets that are measurable and under the control of the private operator, and to link the private operator's remuneration to these targets. Another challenge is determining what powers the private operator should have over, for example, employment. Usually, under management contracts the public company employs the staff, except for top managers. As not many risks are transferred to the operator, improvements in operating and investment performance are less likely to occur than under other arrangements. Operating performance may improve as a result of designing performance targets in a way that will motivate the private operator, and giving the operator the power to change business practices. In some contracts, achievement of performance indicators is audited by an independent, third party.

A management contract may serve as an interim arrangement in preparing for a deeper form of private participation.

3. Lease/affermage

In a lease contract a private operator rents the facilities from the public institution, typically for five to ten years. Under the lease contract the lessee pays a fixed fee to the lessor, while in the affermage arrangement, the fee is set as a portion of the revenues from water supply. In France, duration of affermage-lease contracts is limited to 20 years. The private operator bears full commercial risk, is responsible for operation, maintenance and management of the system (activities and assets). Typically, the leaseholder will finance working capital, replacement of short-lived assets and/or rehabilitation costs. The public institution retains responsibility for fixed investments and debt servicing. The quality of services is defined in the contract and monitored by the public institution through a specially created department.

The leaseholder usually collects the tariff revenue directly and returns an agreed portion, usually fixed, to the public authority as a rental or license fee. The profit for the leaseholder is the difference between the gross revenue and the sum of operating costs plus the fee paid to the public authority. Therefore any efficiency improvements, from bill collection to system operation, results in greater profits for the leaseholder.

4. BOT contracts

Under a Build-Operate-Transfer (BOT) contract a private company or consortium of companies typically finances, builds and operates a new facility. The BOT model has been well developed and often used in the municipal water services sector. A BOT contract model can take many forms, including Build-Own-Operate-Transfer (BOOT), Build-Own-Operate (BOO) and Rehabilitate-Operate-Transfer (ROT).

In the case of BOT the ownership of the facility is transferred to the government at the beginning of its operating life. In the case of BOOT, ownership is transferred after a predetermined period of operations. In the case of BOO, ownership is not transferred but remains with the private company that builds and operates the facility. In the case of ROT, the building activity of the private company involves rehabilitation of existing assets rather than construction of new assets.

The BOT model is an attractive means to mobilize private sector financing for investment in facilities that have historically been funded by the public sector. It usually involves a contract between the private company and the public authority, with various underlying guarantees from the government. Regulation is mostly done through contracts. Mutually satisfactory allocation of risk among the various parties is essential to the successful implementation of any BOT project, although predicting the risks is problematic.

5. Concession (full or mixed)

Under the concession option a private company, or concessionaire, has overall responsibility for the operation, maintenance and management of the system, as well as for financing capital investment required to improve or expand the system. The concessionaire assumes full commercial risk for the system and for the repayment of the financing. Existing fixed assets remain the property of the government or municipality but are entrusted to the concessionaire for the duration of the concession contract. New assets created by the concessionaire are owned by the concession company until they are transferred to the municipality or government at the end of the concession period. Policy is set through the concession contract.

Under a full concession the private investor is responsible for all required investments. Under a mixed concession certain investments remain the responsibility of the government. Typically these are sizeable, discrete investments that (i) are not on the critical path of the level of services outputs contained in the contract and (ii) have a limited or no direct impact on consumers' perceptions — i.e. investments that consumers would not be willing to finance through tariffs. This type of contract has two potential advantages: it reduces the required tariff increase, and it makes a tariff increase easier for consumers to accept. The main disadvantage is that it leaves the government with responsibility for a significant amount of investment, and thus increases the likelihood that some the required investments will not be made.

Concession contracts typically run for twenty to thirty years, depending on the level of investment and the payback period needed for the concessionaire to recover investment costs.

The concessionaire retains exclusive rights to the assets for the duration of the contract. When the contract expires, all works and equipment are turned over to the state or a future concessionaire. If some capital expenditures have not been fully amortized by the end of the contract, the contract usually allows the private company to be compensated accordingly.

The concessionaire is paid for its services directly by the consumer. A tariff adjustment mechanism is typically agreed in the concession contract. The concession company collects tariff revenues from consumers and registers a profit or loss depending on whether those revenues succeed or fail to meet the full cost of operating and financing the system.

6. Outright sale of assets

Outright sale involves the transfer of ownership of the assets to the private sector. Typically this is achieved either by the sale of assets or the sale to private investors of the shares owned by the state in the externalized organization. Policy setting is a matter of contract negotiation. The latitude for negotiation depends on the type of policy — employment, environmental, quality of services etc.

The new private owner has full responsibility in terms of operating, maintaining and managing the system as well as for financing investment needed to improve or expand services. If the new company provides a public service, it will typically operate under a license that stipulates its rights and responsibilities. The private company operates under the same commercial conditions as the concessionaire described above. The same as in the case of a concession arrangement, there is an incentive for the private owner to reduce costs since this translates into higher profits.

D. Comparative review of externalization options

This chapter is based on the draft WB report: World Bank Toolkit for Privatizing Water Utilities. Before assessing the suitable type of externalization arrangement, it is necessary to review critical differences among them. One difference is recovery of costs for new investment. Under a full concession contract, the investor/operator and lenders finance all the required investments and repay/recoup the financing exclusively from tariffs. The mixed concession excludes from the contract and the tariff investments to be financed by the public sector. The affermage contract places on the private operator the responsibility to operate the assets and finance any associated working capital investment, thus, placing a much lower burden on the tariff and a much higher burden on the government. The management contract places on the private operator the responsibility to manage the company without any responsibility for investment, either tangible or intangible. Table 2 summarizes these differences among the contracts in this key respect.

Tables 3, 4, 5 6 and 7 show a comparison of the options available for the various types of externalization (concession, affermage, management contract, etc) — and in one table the type of entity to which an activity or asset is externalized — to specific externalization objectives. The information these tables present may be used to develop criteria to select externalization options and contract winners. An important criterion in deciding on the approach is the ownership of the assets (public or private) and the Romanian legal limitations resulting from this.

Table 3 illustrates the way costs (working capital and investments), are financed under various externalization alternatives and the impact of such costs on tariffs charged by the new entity, resulting from the externalization process and on ANAR spending. Depending on the

externalization vehicle, some costs may be shared between the private investor and ANAR, while some costs may be entirely on ANAR, or on the private investor.

Table 3. - Externalization arrangements and their effects on ANAR spending

Expense	**Concession**	**Mixed concession**	**Affermage**	**Management Contract**
Working capital	Financed from revenues (tariff). ANAR not required to finance			High financial burden on ANAR. No burden on tariff as private investor is not required to fund either working capital, or investments
Fixed asset rehabilitation and renewal	Investments financed from revenues (tariff), by private investor. ANAR not required to finance investments	Investments financed from both revenues (tariff), by private investor and ANAR funds[6]	Investments financed by ANAR. No burden on tariff as private investor does not finance investments	
Fixed asset expansions and new plants				

Table 4 provides basic information aimed to assist in selecting the type of externalization vehicle, depending on the objective(s) ANAR top management intends to achieve through externalization. In other words, in the first column, the table shows the recommended externalization vehicles for achieving specific objectives - shown in the other columns -, through skills or features contributed by the private investor. We assume that the process to select the private investor is properly conducted. For example, in case ANAR only wants access to additional technical expertise, it will sign a service contract with a private provider that can contribute the specific skills. ANAR may achieve all objectives mentioned in the second row, columns 2-6, through sale of assets or concession.

Table 4. - Advisable type of externalization vehicle for achieving ANAR objectives

Externalization vehicle	**ANAR management objective for externalization**					
	Access to additional technical expertise	Improved management	Increased operating efficiency	Increased investment capabilities[7]	Responsiveness to consumers	Insulation from political intervention
Service Contract	x					
Management contract with fixed fee	x	x				
Management contract with performance incentives	x	x	x			
Lease	x	x	x		x	x
BOT	x	x	x	x		x
Concession	x	x	x	x	x	x
Sale of assets	x	x	x	x	x	x

Table 5 shows allocation of main responsibilities between ANAR and the private investor (referred to as "private" in the table), for different types of externalization vehicles. In the second column, the table shows typical duration for which a contract is signed with the private investor, depending on the externalization vehicle. For example, in case externalization is done through a concession contract, the contract is typically signed for a period between 25-30 years, assets continue to be owned by ANAR, the concessionaire is responsible, for the

[6] Government and Municipal funds, including sovereign-guaranteed loans repaid from governmental sources of revenue
[7] Private operator's equity contribution and experience in securing loans

period of the contract for: operation and maintenance, ensuring capital investment and completely assumes commercial risk.

Table 5. - Allocation of key responsibilities in private sector participation

Option	Typical contract duration	Asset Ownership	Operations and maintenance	Capital Investments	Commercial risk
Service contract	1-2 years	ANAR	ANAR and Private	ANAR	ANAR
Management contract	3-5 years	ANAR	Private	ANAR	ANAR
Lease	8-15 years	ANAR	Private	ANAR	Private and ANAR
Concession	25-30 years	ANAR	Private	Private	Private
BOT/BOO	20-30 years	Private and ANAR	Private	Private	Private
Divestiture	Indefinite (may be limited by license)	Private or Private and ANAR	Private	Private	Private

Table 6 completes Table 4, in that it summarizes the generic contribution that different types of investors may bring to the table following externalization. For example, in case ANAR decides that, in order to keep, or make the newly created entity viable, specific technical expertise is needed, as well as equity capital for development and even access to international loans, with better conditions than those offered by local banks, ANAR will look for an international water operator. In case ANAR decides that what the new entity needs is limited equity capital and good knowledge and/or presence on the Romanian market, ANAR will look primarily for a Romanian investor. Romanian investors may be financial, or investors with limited financial capabilities, but with good contacts in and knowledge of the Romanian market. One such typical case may be a local water operator, holding a proper license.

Table 6. - Potential contribution to the new company of private investors

Externalization made to:	Technical Expertise	Equity Capital	Experience in securing international loans	Local Knowledge /Presence
International water operators	x	x	x	
International financial investors		x	x	
Romanian investors		x		x

Table 7 shows the effect of private sector involvement in the externalization deal on: tariffs, quality of services, future privatization. The first column describes specific objectives that ANAR may have in the externalization deal in terms of: magnitude of tariffs and quality of services, including monopolistic behavior; privatization and achieving self sustainability, with the lowest burden on ANAR. The first row, columns 2-5 mention the externalization vehicle. This table should be read in conjunction with Table 5, which describes responsibilities of ANAR and of the private investor, once the externalization deal is closed. Table 7 reads that privatization may be achieved for any of the vehicles mentioned in row 1, columns 2-5. Vehicles mentioned in these columns may be used to test the viability of the newly formed entities, in view of later privatization. Also, row 3 reads that externalization contracts are important to avoid monopolistic behavior, with negative impact on tariffs and quality of services. Rows 2 and 4 shortly describe the potential effects of division of responsibilities shown in Table 5, on the parameters considered in Table 7.

Table 7. - Impact of private involvement on tariff, quality of services, privatization

Impact	**Management Contract**	**Affermage**	**BOT**	**Concession**	**Sale of Shares or Assets**
Lowest possible tariffs for highest possible Levels of service (Los) to consumers	No impact on tariff, Marginal impact on Los (better customer relations; shorter emergency response times) No significant impact on quality	Minor impact on tariff Marginal impact on repair and maintenance	Significant impact on tariff (full cost and investment recovery)	Project-specific; limited impact on tariff	Depends on sale contract
Achieve privatization within agreed timeframe	Possible in all cases				
Avoid monopolistic behavior	Depends on the contractual arrangements				
Create a privatized system which is as financially self-sufficient as possible and does not require subsidies from the state budget	No private investment in this case	Private operator will only invest in working capital and maintenance: no investment in renewal, rehabilitation and expansion of the system	Private operator will invest but the amount will be limited and project-specific	Private operator will invest in the renewal, rehabilitation and expansion of the system in order to achieve necessary Los, technical and quality standards	Proceeds from the sale will go to the state budget or into ANAR's budget, but *per se* will not be sufficient to cover all needed investments

VI. EXTERNALIZATION CASE STUDY

In order to illustrate the basic externalization approach as shown in this report, a case study is provided below, involving externalization of a Water Quality Control Laboratory (WQCL).

This case study utilizes data provided by Olt RBD in the survey instrument. We have only "borrowed" data from Olt RBD; this case study is not intended in any way to be an assessment of Olt RBD's decisions with regard to externalizing its laboratory.

The basic assumption of the case study is that, for reasons irrelevant to the case study, the RBD decides to externalize an activity. In the decision making process, the RBD top management considers different options. One of the options considered by RBD top management is to externalize WQCL. We describe a hypothetical analysis of WQCL externalization, using the tools provided in this report. In Subchapter A, we analyze the reasons for which WQCL may, or should be externalized. In Subchapter B we mention some of the issues we think may be appear related to the externalization process. In Subchapter C we demonstrate the use of the simple tools provided by this report. Our aim was rather to call ANAR's attention on issues and not providing solutions to these issues, as they may vary according to local circumstances.

A. Reasons for externalizing WQCL

In this Subchapter we are laying out some basic aspects that should be considered in analyzing the feasibility of externalizing an activity and related assets. We highlighted in Bold the reasons that make WQCL a good candidate for externalization.

Main reasons for selecting WQCL as a good candidate for externalization are the following:

- it is an independent activity, providing information to some of the other departments in the RBD, so **externalizing it will not cause major disruption in the activity of the RBD**
- it is already known on the market, as it performs analytical testing for third parties, so it has a good name and **is likely to easily find additional work, besides work for RBD**
- it is accredited to perform water quality analysis, and consequently (a) potential clients, others than ANAR, are confident to use its services; (b) no high accreditation costs will be needed after externalization (only costs for re-accreditation and/or to extend accreditation to new types of analytical tests will be required); (c) current testing costs include expenses for implementing QA/QC (SR ISO 17025), making it easy to calculate test specific costs; and (d) quality is paramount for development, particularly for a laboratory, so **there are high chances that the new entity will survive on the market**, even with the high competition that will appear following EU accession
- the activity of the laboratory mirrors the monitoring plan; therefore, **the capacity to plan and deliver on time is there**
- **costs are relatively easy to estimate and control**
- the value of necessary investment is known, so **externalization costs as well as costs to the private investor are easier to determine**

B. Main issues to consider

In this Subchapter we illustrate the types of issues that may appear in the externalization process. As already mentioned, our objective is not to provide the solutions to these issues, as these may vary a lot depending on local conditions.

- physical separation will be difficult in case the laboratory is located in RBD's building. Special arrangements may be needed to ensure access of outside beneficiaries, which will increase externalization costs and may impact RBD's main activity
- $600,000 investment is needed, only in terms of analytical equipment, to enable the laboratory to perform all standard tests required by Romanian Water Law. Possible funding solutions include: 1) ANAR takes a loan, before externalization; 2) WQCL applies for a loan, after externalization; the loan may be guaranteed by ANAR, or not; 3) contribution of a partner. ANAR will need to decide on timing of the investment and all consequences of this decision, including financing arrangement and transfer of the debt service
- the new equipment will entail additional costs, such as: preparation of the working space, hiring new personnel (if needed), training personnel, extending the accreditation for performing new types of analytical testing. All these costs must be estimated and added to the cost of externalization. Also, before the externalization documents will be signed, the responsibility for bearing these costs will need to be clearly allocated
- the procurement process of spares and consumables will need to be clearly defined. Various alternatives, such as centralized versus local procurement, sharing spares and consumables stocks, will need to be considered, with their associated costs. In all cases, staff needs and procurement and capital costs, as well as specific procurement responsibilities will have to be defined and allocated. ANAR will need to develop policies for selecting suppliers, eventually procedures for inspecting them, as well as procurement specific QA/QC procedures, to ensure reliability of data and consistency throughout the ANAR network. Specific training may be needed, which will increase externalization costs. Initial working funds need to be estimated and allocated and factored into the externalization costs
- an important decision regards equipment maintenance. Alternatives will need to considered, such as building in-house capabilities versus centralized, or regional capabilities, or outsourcing to specialized company(ies), if this type of service(s) is (are) available on the market. Costs will need to be attached to each option and compared. Costs may include hiring new staff, training, keeping stocks. The same applies to equipment calibration and periodic equipment re-certification. Once cost will be determined, they need to be included in the tariffs and compared to the current costs of testing
- in order to ensure consistency and allow for comparing testing results, the new entity shall keep participating in the intercalibration tests conducted by ICIM [8]. ANAR may decide to bear the costs of this participation, as it is water quality specific, or participation may be subsidized through funds provided to ICIM, or pertaining costs may be included in the tariff, which may reduce competitivity of the new lab, as opposed to other labs that are not required to participate in this exercise
- currently, ANAR bears continuous education costs. These costs will need to estimated and continuous education will need to be well planned in advance. Probably these costs will need to be factored into the lab tariffs and be covered from revenues
- ANAR may decide to assign the new lab the duty to continue participating in international programs. Again, costs for this participation will need to be assessed and the source for covering them defined

[8] ICIM (Environmental Engineering Institute) has the reference laboratory for MEWM. ICIM conducts periodic inter calibration with all water labs belonging to MEWM structures

- once the above costs will be assessed and the source for financing them defined, the cost of analytical tests performed by the new lab will be assessed and compared to the current costs for analytical testing to ANAR
- currently, the lab is part of the RBD. Once externalized, the lab will need to be properly managed. In case managerial capability is not available in WQCL/RBD/ANAR to ensure its development and increase its market share, a person will adequate knowledge and skills will need to be found and hired, which will add to the cost of externalization
- as the lab will not be part of the RBD anymore and will not be insulated for shocks on the market, its survivability from own revenues needs to be assessed. This entails knowing the competition, its capabilities and tariffs. A special study may need to be developed, which will, again, increase externalization costs
- a realistic development strategy will need to be defined for the new lab, including needed resources (human, materials, financial), for implementation
- in case there are non reimbursed loans taken by ANAR for assets that will be transferred to the new company, a decision will need to be taken, within the Romanian legal framework, on passing this service to the new lab, or not
- ANAR will need to consider several options and develop an externalization strategy, including the set up of new labs, such as centralized managed network, or centralized services for the network, versus, regional, local independent laboratories
- collecting water samples may be costly activity. Responsibility for collecting samples and delivering them to the lab will need to be defined. This activity could be on ANAR, or on the new lab, or may be totally, or partially outsourced
- in order to ease exchange of information, the new lab will need to have access to ANAR VPN. VPN access arrangements will need to be designed as well as code of conduit for accessing VPN and the level of access of the lab staff
- the initial working capital will need to be assessed and allocated, part of the externalization costs.

C. Selecting the externalization option

In this Subchapter, we make illustrative assumptions and shortly demonstrate the use of the simple tools provided in this report.

We assume that ANAR has the following objectives for externalizing WQCL:

- ensure aggressive management that will develop WQCL
- ensure required investment funds
- as results of analytical tests are opposable to third parties in litigations, maintain WQCL's prestige and objectivity
- secure preferential treatment for ANAR in dealing with emergencies

We assume that WQCL assets are in the "private property of the state", so we have complete freedom in selecting the option for externalization (Table 2).

From Tables 3, 4, 5, 6 and 7, it seems that the option that will lead to achieving the above objectives is **"concession to an investor**" (financial or other kind). In this case,

- ANAR maintains property of the WQCL assets, which ensures special treatment

- the investor contributes: managerial experience, capital, access to loans
- the impact on tariffs is limited
- WQCL may be privatized at a later date
- through the provisions of the concession contract, the investor may be interested to increase the capabilities of WQCL in terms of: equipment, increase personnel's skills, etc. Upon termination of the contract, the new assets will be transferred to ANAR/DA
- the investor will be interested to encourage participation in various activities, to increase the fame of WQCL, to make it known on the market.

Once concession was selected as option for externalization, we need to observe provisions of Law 219/1998, modified and completed by Law 528/2004 and the Framework guidelines to apply Law 219/1998. WQCL activity may be concessioned, as it is mentioned as such in Art. 2 (g) of Law 219/1998, modified. In order to initiate the concession process, the concessor needs to develop an opportunity study, the content of which is described in Art 7(1) of Laws 219. According to Art. 7(2), the Terms of Reference (ToR), are developed based on the findings of the opportunity study. The concession is approved by a Decision of GoR, based on the ToR. According to Art. 10, "*concession is granted through public bidding, direct negotiation, or through competitive dialogue"*.

VII. CONCLUSIONS

Externalization requires addressing complex issues dealing with transfer of assets and functions of the old activity to the newly formed entity and also allocation of financial, environmental and other liabilities, development of personnel related policies, and so on. It is up to ANAR to decide on activities and assets it will externalize as well as on the externalization vehicle. We hope that this report will support ANAR management to approach externalization in an informed manner.

General conclusions:

- ***at least three initial conditions need to be fulfilled before initiating externalization: 1) define ANAR's structure following externalization; 2) assign the agency that will be responsible to set up and organize the externalization process; 3) ensure funds to finance costs entailed by preparatory, bidding and negotiation activities and separation of the new entity from ANAR structures***
- ***comprehensive materials need to be developed, such as: opportunity study; guidelines for developing ToR; instructions for setting up and conduct externalization, which need to materialize in a decision of GoR; ToR etc.***
- ***externalization is a sensitive process, that requires in depth study of various issues, some of them mentioned in the report; an externalization plan is developed based on findings of these studies. In case externalization is not properly conducted and controlled, it may do more harm than good***
- ***ANAR has reached a point where externalization may not be performed in the absence of a well defined plan, developed based on thorough consideration of several well justified options. More in depth externalization was performed in other domains of the Romanian economy, based on dedicated GoR strategies and on studies performed by experienced consultants and analyzed by all stakeholders. The processes were conducted in steps. The water sector is very important both for industry and the public at large. Externalization in the water sector will be felt be the whole population of Romania, which requires careful consideration***
- ***services procured from the new companies may cost more by the value of VAT. However, unit prices will need to be compared in order to have an idea of the true cost***
- ***mere observation of the steps to be followed in the externalization process does not necessarily lead to success. Successful externalization depends greatly on the instruments used in the process, such as: contracts, policies, code (s) of conduit, licensing conditions, certification requirements etc.***
- ***ANAR/DA will need to periodically review achievement of conditions stipulated in the externalization contracts. This entails setting up of special log books, such as requested by the Methodological guidelines for implementing Law 219/1998, Art. 3). Managing the externalization contracts will also entail dedicated staff and effort***

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